House Policy Committee

Policy Perspective

The Sunset of the Economic Growth Act

On June 7, 2001, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001, which included provisions of six permanent tax relief bills approved by strong bipartisan House majorities.[1] Title IX of the Act, added by the Senate to avoid a minority procedural challenge to the bill, provides that tax relief will expire December 31, 2010.

No substantive or rational policy basis justifies this "sunset." It was added to the legislation at the last moment as a procedural anomaly.

Left unchanged, the sunset will cause a multi-billion dollar tax increase on January 1, 2011. The income tax rate for top earners will rise from 35% to 39.6%, while the rate paid by lower-income taxpayers will shoot up 50%. The child tax credit, another provision particularly helpful to many lower-income taxpayers, will be halved, from $1,000 to $500. The annual contribution limit on IRAs will plunge 60%, from $5,000 to $2,000. The marriage penalty will reappear. And the death tax—phased out by January 1, 2010—will come back from the grave, fully regrown to its 2001 expense on January 1, 2011.

1. The six permanent tax relief bills approved by the House were:
   - H.R. 3, the Economic Growth and Tax Relief Act of 2001, approved 230-198, March 8, 2001 (reducing five income tax brackets to four: 10%, 15%, 25%, and 33%)
   - H.R. 6, the Marriage Penalty and Family Tax Relief Act, approved 282-144, March 29, 2001
   - H.R. 8, the Death Tax Elimination Act of 2001, approved 274-154, April 4, 2001
   - H.R. 10, the Comprehensive Retirement Security and Pension Reform Act, approved 407-24, May 2, 2001
   - H.R. 586, the Fairness for Foster Care Families Act, approved 420-0, May 15, 2001 (treating payments from private and government foster care placement agencies equally)
   - H.R. 622, the Hope for Children Act, approved 420-0, May 17, 2001 (expanding the adoption credit)

The Senate combined the bills and sunset them to overcome minority objections. They became Public Law 107-16.

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A New York Times columnist called the one-year repeal and immediate reinstatement of the death tax the “Throw Momma from the Train Act,” because the only way to create an effective estate plan is to die in 2010—the one and only year when the death tax is completely repealed.

The sunset also means that provisions in today’s law to encourage college savings won't help parents with younger children—because they terminate in 2011. The tax deduction for qualified higher education expenses is worthless for parents planning to pay for college for their children under 13, because it will sunset after 2005.

These and other perverse consequences of the sunset are creating confusion and frustration among taxpayers. Tax law changes meant to improve the economy and taxpayers’ lives are instead frustrating personal and government planning, and restricting economic growth.

On July 26, 2001, the House Policy Committee met with representatives of millions of taxpayers, senior citizens, small business entrepreneurs, employers, tax policy experts, and budget experts concerned about the pernicious effects of the sunset. Each of the principals agreed that it is impossible to establish a logical policy rationale for making the Economic Growth Act temporary.

The participants agreed that not only does the sunset provision impair the very growth Congress intended the Economic Growth Act to stimulate, but furthermore taxpayers are enduring needless complexity as they attempt to plan their pensions, their retirement accounts, their small business succession, and their children’s education. The policy chaos caused by the sunset is frustrating taxpayer planning and making it vastly more expensive.

Even those who do not pay taxes will suffer the consequences of the sunset provision. For example, small businesses which will be subject to a full-strength death tax in 2011 won’t be able to protect the jobs of workers when the founder dies. Sole proprietors worried about succession planning will be reluctant to expand their businesses because unless they die before 2011, the IRS will confiscate half of the value of any expansion.

Only full repeal of the tax sunset can fully address these problems.

Increasing Federal Revenue and Growth

On a foggy morning at his Santa Barbara ranch 20 years ago this month, President Ronald Reagan sat at a rustic leather-covered table and signed into law permanent tax relief that reduced the maximum personal income tax rate from 70% to 50% and the tax on savings and investment (capital gains) from 50% to 20%. Five years later, he signed legislation lowering rates again and reducing the income tax to just two brackets, 15% and 28%.

In the 20 years since this landmark legislation, lower taxes have helped kill record inflation. Employment, wages, and productivity have soared almost uninterruptedly for two decades in the longest sustained economic boom in American history. Lower interest rates have made homeownership affordable for millions more Americans. Lower tax rates have multiplied federal revenue three and a half times. For good measure, this record government revenue financed America's Cold War victory over the Soviet Empire, freeing a billion people from totalitarianism.

For the Unites States to continue as leader of the free world, we must vigilantly promote economic growth at home by pursuing a policy of moderation in tax rates. Not only taxpayers, but all Americans and people throughout the world will benefit from this policy, because it means more jobs, higher wages, lower prices, greater economic opportunity—and more federal revenue.

Because of the U.S. progressive tax rate structure, the economic growth of the past 20 years has made tax collections grow far faster than the economy itself. As a result, the tax burden on Americans is five percent higher than it was when President Reagan signed the Economic Recovery Act into law. Federal revenue is now at a record peacetime high, accounting for 21% of the economy compared to 17.6% in 1993. This large a slice of the economy hasn't been taken by the federal government except for one other year in history.

Now, the economy is beginning to show the strains of such a heavy burden.

The New York Times reports that for the first time in the 20-year history of 401(k) retirement plans, these retirement funds lost money in 2000. The personal savings rate is at or near zero. Reports released in the second half of July 2001 show that the earnings of public companies were down 17% from the same quarter a year ago—the first decline in annual profits in a decade. (The last such drop occurred in 1991, when the top marginal income tax rate was raised from 28% to 31%, causing a recession). In 2001, venture capitalists are investing less than half amount they did last year to finance new employment and technical innovation. "From the middle of 2000 to the middle of this year," the *Times* reports, "the economy grew [at] the slowest 12-month pace in nearly 10 years."

Without a permanent and predictable policy of economic growth, both government revenue and the private economy will suffer.

According to the Staff Director of the Joint Committee on Taxation, the Committee did not even consider the effects on economic growth from making the Economic Growth Act temporary. As a result, a last-minute change in the Act pursuant to an obscure Senate procedural rule has made a hash of the law's fundamental purpose.

The Solution

Reps. Kenny Hulshof (R-MO) and Paul Ryan (R-WI) have introduced H.R. 2316, which strikes Title IX (the so-called "sunset" provision) from the Economic Growth and Tax Relief Reconciliation Act, making the tax law changes in the Act permanent. More than 40 Senators have already agreed to sponsor the legislation in the Senate.